



VIRGINIA SMALL BUSINESS
FINANCING AUTHORITY
ECONOMIC DEVELOPMENT CLUSTER
FEDERAL PROGRAM

REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2017

Auditor of Public Accounts
Martha S. Mavredes, CPA
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AUDIT SUMMARY

Our primary focus was the audit of the Economic Development Cluster federal program, administered by the Virginia Small Business Financing Authority (Financing Authority) for the fiscal year ended June 30, 2017. Our audit found:

- the financial information is presented fairly, in all material respects, in the Financing Authority's financial and loan tracking systems and in the Federal Schedules attachment submitted to the Department of Accounts;
- one matter involving internal control and its operations necessary to bring to management's attention; and
- one instance of noncompliance with applicable laws and regulations or other matters that are required to be reported.

We also performed analytical procedures over the remaining direct and indirect loan programs administered by the Financing Authority and noted no major changes in program utilization or default rates or in the calculation of default rates.

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AUDIT FINDING AND RECOMMENDATION

Improve Controls over Federal Reporting

Type: Internal Control and Compliance

Severity: Material Weakness

Repeat: No

The Virginia Small Business Financing Authority (Financing Authority) does not have adequate controls in place to ensure accurate federal reporting on the ED-209 “Revolving Loan Fund Semi-Annual Financial Report” (ED-209) for the Economic Development Cluster (EDC) Federal Program. This report is submitted semiannually to the Economic Development Administration (EDA). The Financing Authority does not have policies and procedures or a formal documented review process over this required report. As a result, of the nine ED-209 reports reviewed, the following instances of noncompliance were noted:

- Four reports had material variances between the report and support on key items; and
- Six reports had material variances between the report and support on non-key items.

Additionally, the Financing Authority does not retain sufficient support for some of the material amounts reported to the Economic Development Administration (EDA).

Title 13 CFR §307.14 (b) states that all RLF recipients must certify that the information provided on the ED-209 report is “complete and accurate.” As the reports contain section subtotals, reporting inaccurate information can lead to the material misstatement of key line item totals. Additionally, this report contains “inception-to-date” information, so errors in one reporting period can impact future reports. Further, EDA uses the reports to manage its Revolving Loan Fund (RLF) portfolio. Inaccurately reporting material amounts not only limits their ability to manage the portfolio, but could also result in improper program funding.

The Financing Authority obtained the federal program from another agency and did not receive procedures on the required report upon receipt. Further, due to the limited number of staff in the agency and in order to meet deadlines, unsupported hand calculations were used to fill in some material line items.

The Financing Authority should implement policies and procedures, to include a documented review process, over the reporting process to ensure accurate reporting of RLF information to EDA and retain all support for material amounts reported.

AUTHORITY BACKGROUND AND ANALYTICAL INFORMATION

The Virginia Small Business Financing Authority (Authority) has been in existence since 1984 and provides financial assistance to Virginia-based businesses through bond issuances, direct loans, loan guarantees, and portfolio loan loss reserves as well as other technical assistance. The exact nature and number of programs administered by the Authority have continually changed over time based on market need and funding resources available. The Authority's financing programs fall into three broad categories: bonds, direct assistance, and indirect assistance.

Through the bond program, the Authority provides Virginia businesses and 501(c)(3) non-profits with access to low cost bond financing which they would otherwise not be able to obtain on their own. The Authority serves as a conduit issuer of tax-exempt and taxable industrial development bonds for qualifying businesses and 501(c)(3) entities. The private sector provides the bond financing, not the Authority or the Commonwealth; and the respective small business or non-profit entity has responsibility for debt service. As such, the Authority takes on no risk related to this program. Therefore, the bond program was not included in the scope of our audit.

The direct assistance programs provide loans to qualified Virginia businesses and 501(c)(3) organizations, while the indirect assistance programs provide support to Virginia businesses through loan guarantees, cash collateral, and loan insurance programs. The goal of these programs is to encourage economic development through either job creation or retention by small businesses, while striving to recapture public funds over time for future credit requests.



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

March 13, 2018

The Honorable Ralph S. Northam
Governor of Virginia

The Honorable Robert D. Orrock, Sr.
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the Economic Development Cluster federal program, administered by the **Virginia Small Business Financing Authority** (Financing Authority) for the year ended June 30, 2017. In addition, we performed analytical procedures over the remaining direct and indirect assistance programs of the Financing Authority as detailed below. We conducted this performance audit in accordance with generally accepted government auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, for the objectives performed in support of the Commonwealth's Single Audit. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our audit's primary objective was to audit the Economic Development Cluster federal program in support of the Commonwealth's Single Audit. In support of this objective, we evaluated the accuracy of Financing Authority's financial and loan tracking systems and in the Federal Schedules attachment submitted to the Department of Accounts; reviewed the adequacy of Financing Authority's internal controls over the federal program; and tested compliance with applicable laws, regulations, contracts, and grant agreements. We also performed analytical procedures over the remaining direct and indirect assistance programs administered by the Financing Authority that were not audited in support of the Commonwealth's Single Audit, to determine whether there were significant changes in program utilization or default rates and that default rates were being calculated correctly.

Audit Scope and Methodology

The Financing Authority's management has responsibility for establishing and maintaining internal control and complying with applicable laws, regulations, and grant agreements. Internal control

is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws, regulations, and grant agreements.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered significance and risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the Economic Development Cluster federal program.

We performed audit tests to determine whether Financing Authority's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws, regulations, and grant agreements. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and observation of Financing Authority's operations. We also tested details of transactions to achieve our objectives.

A nonstatistical sampling approach was used. Our samples were designed to support conclusions about our audit objectives. An appropriate sampling methodology was used to ensure the samples selected were representative of the population and provided sufficient, appropriate evidence. We identified specific attributes for testing each of the samples and when appropriate, we projected our results to the population.

For the remaining active direct and indirect assistance programs that were not audited in support of the Commonwealth's Single Audit, we completed trend analyses relating to new loans issued, default rates, and jobs created and saved during the fiscal year.

Conclusions

We found the Financing Authority properly stated, in all material respects, the amounts recorded and reported in its financial and loan tracking systems and in the Federal Schedules attachment submitted to the Department of Accounts for the Economic Development Cluster federal program.

We noted a matter involving internal control and its operation and compliance with applicable laws, regulations, contracts and grant agreements that requires management's attention and corrective action. This matter is described in the section entitled "Audit Finding and Recommendation."

Since the finding noted above has been identified as a material weakness, it will be reported as such in the "Independent Auditor's Report on Compliance for Each Major Federal Program; Report on Internal Control over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by Uniform Guidance," which is included in the Commonwealth of Virginia's Single Audit Report (Single Audit) for the year ended June 30, 2017. The Single Audit is available on APA's website at www.apa.virginia.gov.

Based on analysis performed, we noted no significant changes in program utilization or default rates. In addition, based on analysis performed, we determined that default rates were being calculated correctly.

Exit Conference and Report Distribution

We discussed this report with management on March 22, 2018. Management's response to the findings identified in our audit is included in the section titled "Agency Response." We did not audit management's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

KJS/alh

April 10, 2018

The Auditor of Public Accounts
P. O. Box 1295
Richmond, Virginia 23218

Dear Ms. Mavredes:

Thank you for allowing me the opportunity to review your audit finding and recommendations. I am providing the following management response to the audit finding and recommendations listed in the single-program audit report.

Finding: The Virginia Small Business Financing Authority (Financing Authority) does not have adequate controls in place to ensure accurate federal reporting on the ED-209 "Revolving Loan Fund Semi-Annual Financial Report" (ED-209) for the Economic Development Cluster (EDC) Federal Program, which is submitted semi-annually to the Economic Development Administration (EDA). Recommendation: APA has recommended that the Financing Authority implement policies and procedures, to include a documented review process, over the reporting process to ensure accurate reporting of RLF information to EDA and retain all support for material amounts reported.

I would like to take the opportunity to point out that the source documents utilized to prepare the semi-annual ED-209 report and the annual SEFA report – specifically, the Financing Authority's monthly LaPro loan accounting reports and monthly Fund Accounting reports – accurately report the significant financial data for each reporting period covered under this audit, including (but not limited to): cash, accounts receivable, interest on loans, interest on cash, the capital base, and the equity contribution. The inaccuracies noted on the semi-annual reports and annual report were not related to cash, accounts receivable, interest on loans, interest on cash, the capital base, or the equity contribution but were instead related to EDA specific reporting metrics not utilized in any other reporting done by the Authority. The calculations for these EDA specific metrics have historically been done manually by staff utilizing information from the referenced source documents. These manual calculations have obviously increased the opportunity for human error. In addition, the Financing Authority has previously lacked sufficiently detailed desk procedures for the preparation of these reports.

The Economic Development Administration (EDA) has recently updated its report format for the semi-annual ED-209 report and as a part of that process has provided participants with detailed instructions on the completion of this new report format. Additionally, the Financing Authority is in the process of creating detailed instructions for the preparation of the annual SEFA report. The Financing Authority is also modifying its source documents to include all EDA specific metrics relevant to the semi-annual report, thereby alleviating the need for any manual calculations. Finally, the Financing Authority has instituted a formal review process of these reports to insure accurate reporting of all report metrics.

Thank you again.

Sincerely,



Anna B. Mackley
Interim Executive Director/ Chief Credit Officer and Operations Manager
Virginia Small Business Financing Authority

Cc: Tracey Jeter, Director, Department of Small Business and Supplier Diversity
Gail Letts, Chairman of the Board of Directors, Virginia Small Business Financing Authority

VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

As of June 30, 2017

Anna Mackley, Interim Executive Director and Chief Credit Officer

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